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Clash of the titans

Environmental policy vs. bankruptcy policy

By John R. Bashaw

Bankruptcy courts typically interpret the federal policy of giving financially troubled companies a fresh start, while civil courts interpret environmental cleanup policies. Until recently, the two sets of policy issues have met only rarely. However, as economic conditions put a financial squeeze on businesses and environmental issues increasingly surface, bankruptcy and civil courts find that the two policy areas meet head-on with little room for compromise.

Onerous cleanup obligations often force businesses into bankruptcy, and bankruptcy courts face the unenviable choice of deciding which policy will prevail. The choice is between allowing debtors to reorganize without fulfilling environmental obligations or requiring that environmental problems be resolved before confirming reorganization.

Until now, courts have dealt sporadically with the clash between Bankruptcy Code policies and federal environmental protection laws. However, conflicts between the two increasingly arise when companies with existing or potential environmental liabilities file for bankruptcy protection. The key question is whether bankruptcy should serve to reduce a company's environmental liability.

The Bankruptcy Code. Three primary issues concern debtors, their creditors, and EPA and state environmental agencies with respect to enforcing environmental laws in the context of a Chapter 7 (liquidation) or Chapter 11 (reorganization) bankruptcy proceeding. These are:

- Under what circumstances can a debtor use bankruptcy proceedings to relieve itself of environmental liabilities?
- Is priority given to payment of costs associated with cleaning up a debtor's contaminated property over the claims of others, such as vendors, debt holders and stockholders? and
- When can a trustee of a bankrupt estate abandon contaminated property because it renders the estate's value worthless?

Filing a Chapter 7 or Chapter 11 bankruptcy petition vests the bankruptcy court with jurisdiction over all of a debtor's property and places an "automatic stay" against enforcement of judgments against the debtor or the commencement of additional lawsuits. However, automatic stays usually do not bar government agencies from enforcing environmental laws, as long as the government is not trying to enforce a monetary judgment against an estate. Thus, a debtor with environmental problems may not be able to rely on the automatic stay provision to forestall equitable actions by EPA to force cleanup of the debtor's property.

The key issue is whether provisions of the Bankruptcy Code or environmental laws take priority. To resolve it, a bankruptcy court must balance the interest of the corporation and its creditors against the often opposing interest of safeguarding public health and the environment.

Environmental protection laws. Although many environmental laws may be impacted by the filing of a bankruptcy petition, CERCLA has had the greatest financial impact on the business community and on bankruptcy cases. Under CERCLA, EPA may conduct a removal or remedial action whenever a facility releases or threatens to release a hazardous substance, including those regulated under CWA, CAA, RCRA and TSCA. Alternatively, the Agency may enter into a consent order or issue an administrative order requiring PRPs to take necessary removal or remedial actions.

CERCLA cleanups are expensive, and PRP liability is strict, joint and several, meaning EPA can recover removal and remediation costs from one or all PRPs without proving fault or negligence. Such liability may be imposed if three conditions are met. These are:

- The cleanup site is a facility as defined by CERCLA;
- A release or a threatened release of a hazardous substance has occurred at the facility; and
- The release or threatened release has caused the United States or another eligible party to incur response costs.

Because cleanup costs are high, extreme financial pressure often is placed on corporations involved in CERCLA actions, occasionally resulting in or contributing to bankruptcy.

CERCLA obligations as "claims." One of the first questions facing a bankruptcy court when a debtor has environmental liabilities is whether the liability fits within the broad definition of a "claim" as set forth in the Bankruptcy Code. The definition of claim generally is so broad that almost any claim for damages or cost recovery resulting from environmental harm is a "claim" for purposes of the Bankruptcy Code.

Another key issue is determining when an environmental claim initially arose. Under the Bankruptcy Code, a claim arises at "the time when the acts giving rise to the alleged liability were performed," rather than when the claim was filed. Also, the presence of hazardous substances at a site does not amount to a claim under the Bankruptcy Code; possession — although perhaps nine-tenths of the law — does not necessarily imply CERCLA liability.

Determining what environmental liabilities can be discharged by a bankruptcy court depends on whether a release or threatened release to the environment occurs before or after a bankruptcy petition is filed. If there is a pre-petition release or threatened release of hazardous substances, a contingent claim against the debtor may be discharged by the court, even if it is only partially paid by the debtor. However, because of strong federal environmental policy, strict adherence to the Bankruptcy Code's notice provision must be followed. Failure to inform creditors or the court of environmental claims could result in the court not allowing a discharge of such claims. Similarly, when injury occurs post-petition but is found to be caused by a release or threatened release of hazardous substances before the bankruptcy petition was filed, a claim may be discharged. In other words, regardless of whether a debtor fully reimburses the government for cleanup costs, the debtor may be relieved from further cleanup liability, even if damage occurred after a petition was filed.

If a debtor owns or operates facilities containing hazardous substances that create a threat of post-petition release, post-petition ownership or operation can be a proper basis for

government enforcement action, regardless of any previous discharge by the court for pre-petition releases. According to a recent federal appeals court decision, "if and when sites become ripe for enforcement action, the EPA may act to protect the environment and the debtor cannot avoid its post-petition responsibilities by transferring or abandoning these sites" [*In re Chateaugay Corp.*, 112 Bankr., 513, 525 (Bankr., S.D.N.Y., 1990)]. This finding reflects the fact that a debtor's estate is a "person" for purposes of CERCLA; thus, the estate is liable for post-petition releases of hazardous substances. A debtor also can be compelled to pay fines or comply with cleanup orders.

Administrative priority. Although cleanup costs incurred on pre-petition releases or threatened releases of hazardous substances may be discharged by the court, EPA has claimed that such costs, when assessed post-petition, are entitled to administrative priority for payment out of the debtor's estate. Under the Bankruptcy Code, administrative expenses generally are the first unsecured claims to be paid by a debtor's estate. If environmental cleanup costs are not considered administrative expenses, EPA and other environmental claimants will likely recover only a fraction or none of their costs.

In a recent case, a federal district court ruled that to the extent a company operating under a Chapter 11 reorganization plan continues to own and operate sites where there has been a release or threatened release of hazardous substances, it is under "a continuing obligation to comply with the environmental laws" (*Chateaugay*, 112 Bankr., 525).

The debtor also cannot abandon or transfer such "unproductive" sites. Money spent to comply with environmental laws would be "actual and necessary costs and expenses of preserving the estate," and, therefore, entitled to administrative priority. In addition, civil penalties for post-petition violations also would be entitled to administrative priority.

A polluted site typically is an unproductive asset. Sec. 554(a) of the Bankruptcy Code allows a debtor to abandon unproductive assets. However, the U.S. Supreme Court recently ruled that a bankruptcy trustee cannot exercise its abandonment power in violation of state and federal laws, including environmental protection laws. Therefore, when it is necessary to "protect the public health or safety from imminent and identifiable harm," abandonment is not allowed.

It is estimated that 12 percent to 15 percent of the 800 cases on the docket of the Justice Department's Environmental Enforcement Section involve bankruptcy issues. This "clash of the titans" — environmental policy *vs.* bankruptcy policy — is likely to continue. Recent court decisions provide insights into the probable path of the law, but the path's direction is not clear. Moreover, enforcement of other environmental regulations, such as RCRA corrective action orders, soon will result in similar policy clashes. ▼

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